

A REPORT TO INDIANA CITIZENS ON THE STATE'S FINANCES



*Connie K. Nass
Auditor of State*

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To my fellow Indiana Citizens:

Thank you for taking the time to read this 9th semi-annual Report to Indiana Citizens on the State's Finances. My office prepares this Report to give Indiana citizens a better understanding of Indiana government's true financial condition. Coming mid-way through State government's fiscal year as our legislature enters its biennial budget session, this issue is devoted to providing a snapshot of how the 2005 fiscal year is progressing for Indiana government. Important information to be gleaned from this Report includes:

- **The good news: State tax revenues are up through the first half of the 2005 fiscal year, surpassing prior year levels in all of the "big four" categories!**
- **The bad news: Even with revenues up, the State's Surplus balance as of December 31, 2004 hit a new year-end low, continuing the fiscal downward trend. Indiana government's total cash and investment balances also continue to decline, reaching the precariously low level of \$1.4 billion in November of 2004.**
- **In 2004, Indiana's sales tax generated \$786.8 million for each 1% of tax, on average, and accounted for nearly 47% of state revenues. The individual income tax generated \$1.12 billion for each 1% of tax, on average, accounting for over 35% of revenues.**

This issue starts on page 2 with a simple explanation of where the Surplus balance is at mid-year, and how it relates to revenues collected. Page 3 analyzes state sales and income tax revenues and details, on average, how much revenue each 1% of those taxes generates. Page 4 restates the difference between the reported Surplus at fiscal year end and the True Surplus, taking into account payment delays and the like. Page 5 apportions state government revenues by source, and spending by function. Finally, pages 6 and 7 again present the revenue analysis for the first half of the 2005 fiscal year.

If you have questions or comments about this publication or its contents, please e-mail me at comments@audlan.state.in.us, or call (317) 232-3300. You may also view this report along with other pertinent information on our website at www.in.gov/auditor.

Sincerely,
Connie Nass
Auditor of State

Cash and Investment Balances (all funds) as of December 31, 2004

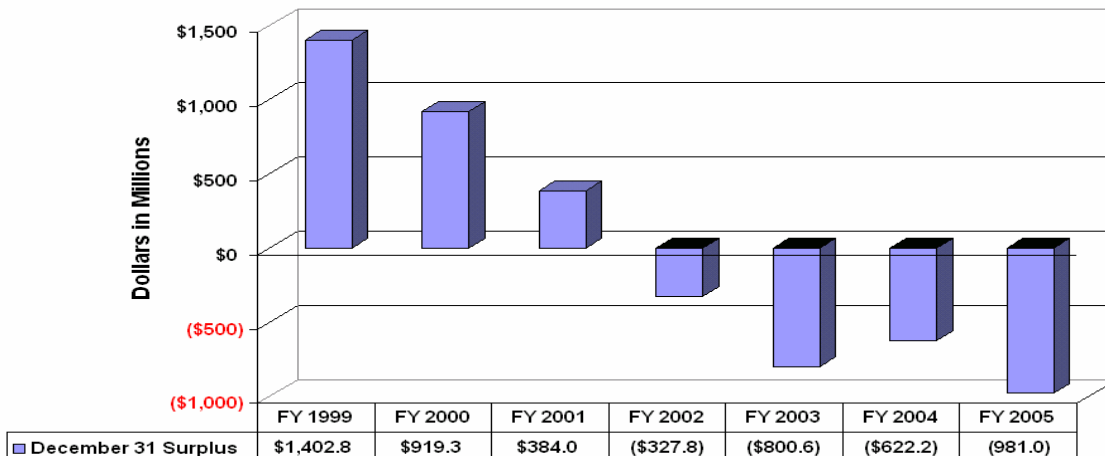
	Surplus Accounts	Non- Surplus Accounts	Total
General Fund Cash and Investments	\$ (1,546,219,143)	\$ 1,074,419,815	\$ (471,799,329)
Rainy Day Fund	220,611,452	(220,611,452)	-
Total General Fund Cash and Investments	(1,325,607,691)	853,808,363	(471,799,329)
Non General Fund Cash and Investments		2,476,405,341	2,476,405,341
Property Tax Replacement Fund	359,258,130	(359,258,130)	-
Total Non General Fund Cash and Investments	359,258,130	2,117,147,211	2,476,405,341
Grand Total All Funds Cash and Investments	\$ (966,349,561)	\$ 2,970,955,574	\$ 2,004,606,012

At Mid-Year, is Indiana Better Off?

December 31 is the mid-point of State government's fiscal year. The chart below shows the Surplus balance at December 31 for the last seven fiscal years. Indiana's "General Fund and Property Tax Replacement Fund Surplus" ("Surplus") is the State's checking account, supporting the day to day operations of State government. By law the Surplus must be no less than zero at each fiscal year end.

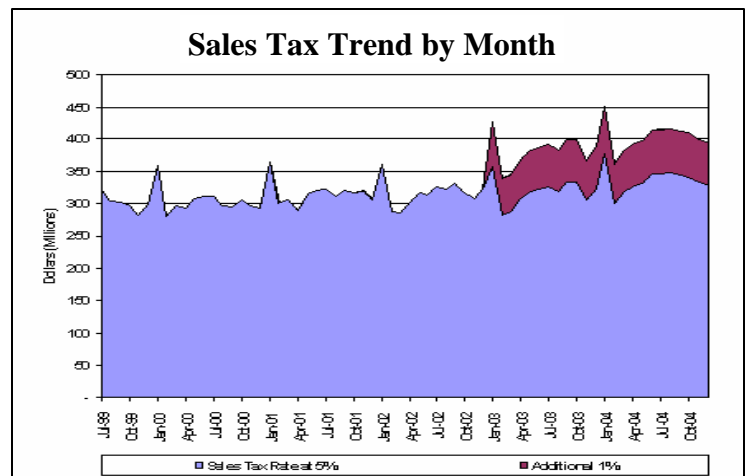
After rebounding slightly in FY 2004, the December 31 Surplus balance for FY 2005 was \$358.8 million lower at a negative \$981 million. That figure is \$180.4 million lower than the prior mid-fiscal year low on December 31, 2002. This is despite the fact that Indiana government collected \$927 million more in sales tax, individual income tax, corporate income tax, and riverboat wagering tax revenues in the first half of FY 2005 than it did in the first half of FY 2003.

**General and Property Tax Replacement Fund Surplus
at December 31st**



That \$927 million increase in revenues breaks down as follows:

- \$525.2 million - Sales Tax
- 200.1 million - Individual Income Tax
- 134.2 million - Corporate Income Tax
- 67.5 million - Riverboat Wagering Tax



The bulk of the increase in sales tax revenues between fiscal years 2003 and 2005 may be attributed to the increase in the sales tax from 5% to 6% that took effect in December 2002. The graph above shows that sales tax revenues have climbed in each of the last six fiscal years.

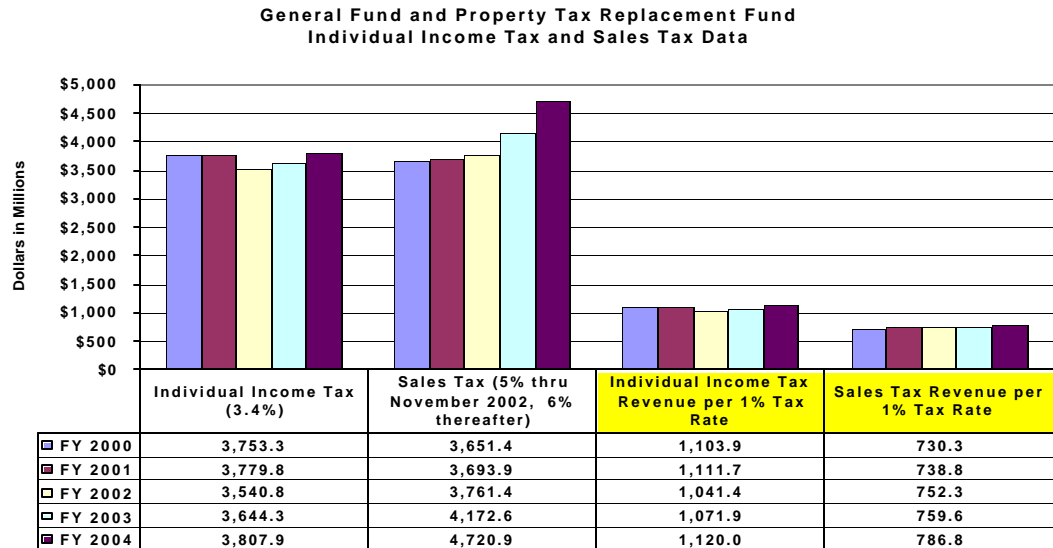
The mid-fiscal year Surplus balance has declined \$2.34 billion over the last six year period from December 31, 1998 to December 31, 2004.

How Much Revenue Did Individual Income and Sales Taxes Generate?

This chart compares individual income tax and sales tax revenues deposited into the General Fund and Property Tax Replacement Fund. It also shows the revenue generated by each 1% of those taxes. The General Fund receives 86% and the Property Tax Replacement Fund receives 14% of the individual income tax. Half of the sales tax revenues goes to the Property Tax Replacement Fund and 49.192% goes to the General Fund.

The remaining 0.808% is distributed to mass transit and rail service funds.

While individual income tax revenue declined on both a real and percentage basis earlier this decade, sales tax revenue has been more stable and in fact it has grown each year.

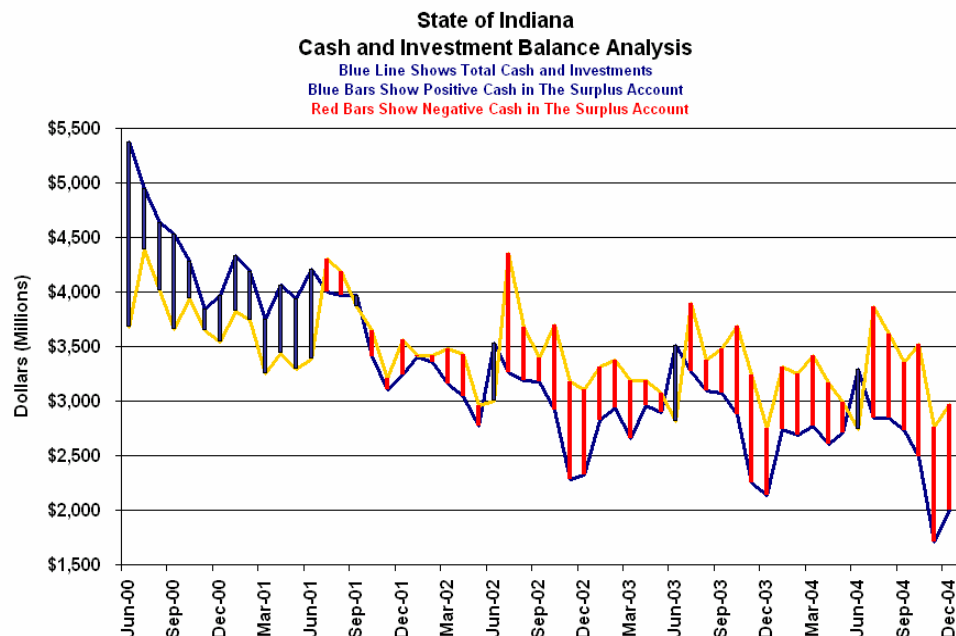


What About Cash and Investment Balances Beyond The Surplus?

The General Fund, which serves as state government's checking account, remains out of money and has been since July 2001 with the exceptions of September 2001 and each fiscal year end. When the General Fund is in a negative position, as illustrated by the red bars in the graph below, the State is relying on money from dedicated accounts to fund its operating expenses. These dedicated accounts are established and earmarked for specific purposes. This money must eventually be replaced.

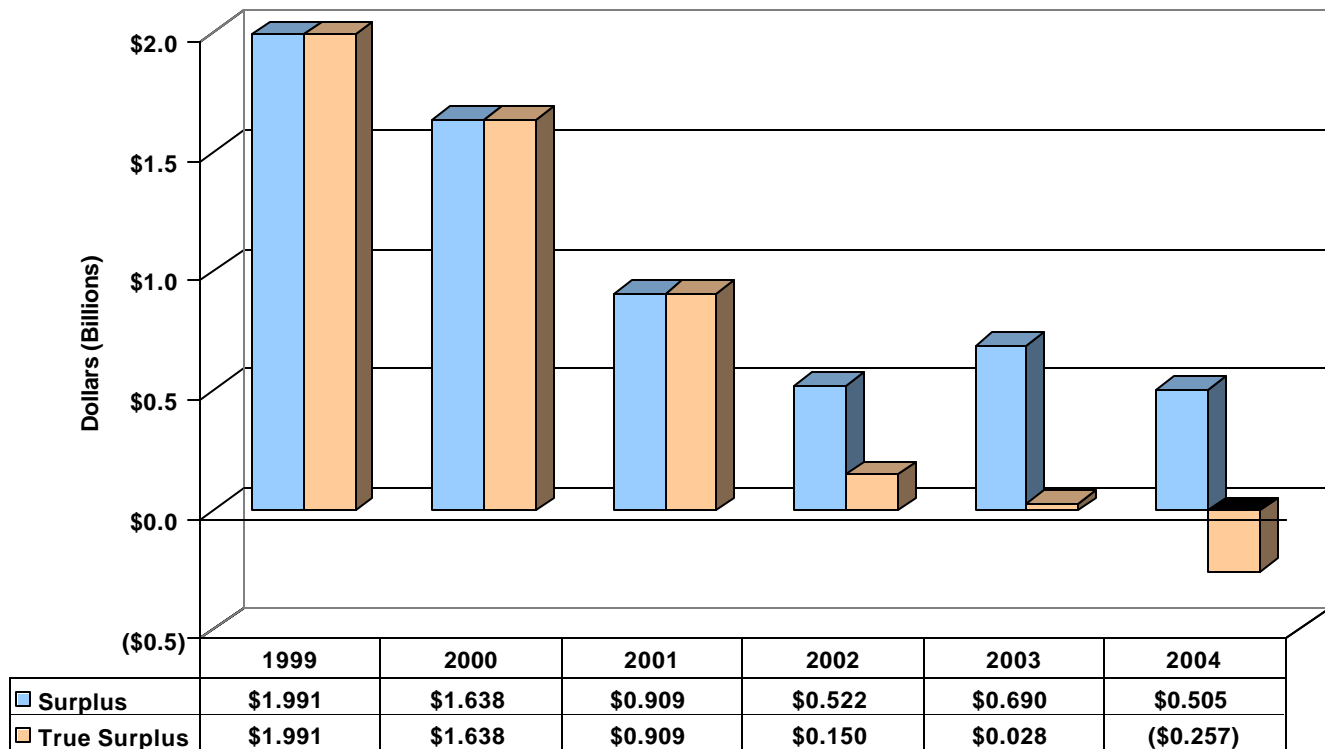
The blue line on the graph shows the total cash and investments in the State's accounts. The yellow line shows what the State's total cash and investments would have been had the surplus (deficit) been zero. As of December 31, 2004, the balance was only \$2 billion which is \$136 million below the \$2.2 billion on December 31, 2003 and \$3.4 billion below the \$5.4 billion on hand on December 31, 2000.

The State's total cash and investment balance reached a low of \$1.4 billion on November 17, 2004.



What is Indiana's True Surplus?

General Fund and Property Tax Replacement Fund
Comparison of Surplus and True Surplus



Indiana's True Surplus has declined by \$2.24 billion over the past 5 years. The graph on this page details the decline from \$1.99 billion on June 30, 1999 to a negative \$256.9 million on June 30, 2004. That is a decrease of 112.9% in 5 years.

Historically, the State Surplus has been its True Surplus – an accurate restatement of how much money remained in Indiana government's operating accounts after that fiscal year's obligations had been satisfied. In recent years, the Surplus and True Surplus have not been the same.

In fiscal year 2002, Indiana government took the step of delaying payments of \$372 million to schools, colleges, and universities beyond the June 30 fiscal year end, generating a \$522 million reported Surplus that, without the delays, would have been a True Surplus of \$150 million.

In the 2003 fiscal year, the education payments were again delayed, as were payments to counties, cities, and towns, for total payment delays of \$662 million. That inflated the reported Surplus to \$690 million, instead of the \$28 million True Surplus of unobligated money remaining in Surplus accounts on June 30, 2003.

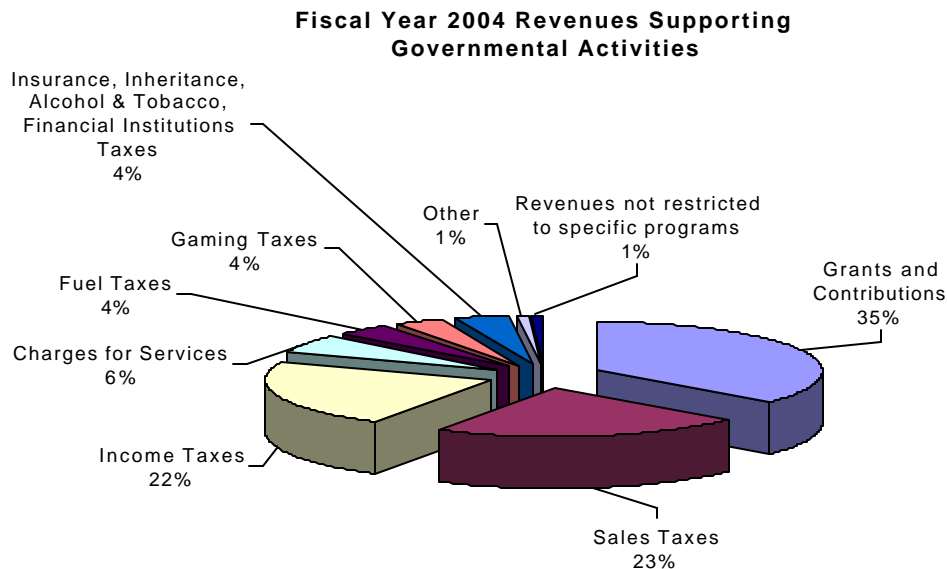
Then, in fiscal year 2004, the delays were used for an unprecedented third consecutive year at the record level of \$712 million. A \$50 million loan from the Public Deposit Insurance Fund was also added to the Surplus balance. Without that \$762 million boost, the True Surplus was a negative \$257 million. It was the first time payment delays were actually necessary at fiscal year end to report a "Surplus" because the True Surplus was in reality a quarter-billion dollar deficit.

FY 2004 Revenues & Expenses of Governmental Activities (GAAP Basis)

Where the money comes from:

Fiscal year 2004 tax revenues of \$12.0 billion represent 57.5% of total revenues for governmental activities.

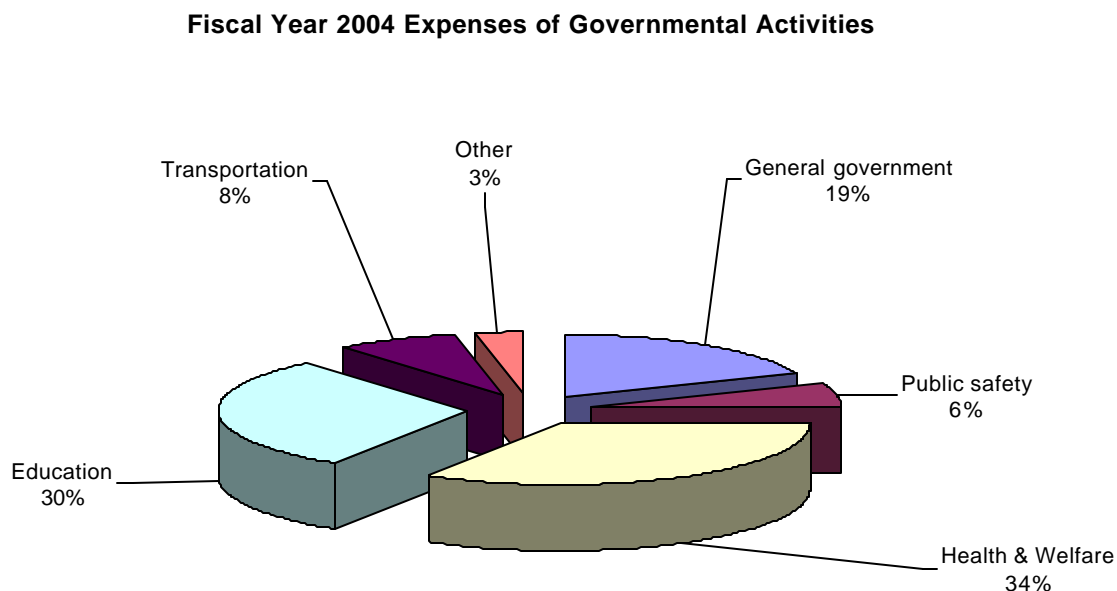
Program revenues accounted for \$8.7 billion or 42% of total revenues. Revenues not restricted to specific programs were \$150 million (0.7%) of total revenues, and of this \$43.1 million was investment earnings. FY 2004 total revenues were 97.1% of expenses as compared to 99.9% in FY 2003.



Where the money is spent:

The largest portion of the State's expenses is for health and welfare, which is \$7.5 billion (34%) of total expenses. 70% of health and welfare is funded through operating grants with the majority of the remainder funded from general revenues. Included in this is \$4.6 billion that was spent for Medicaid assistance.

Education, which makes up 72.4% of FY 2004 General Fund expenditures when Property Tax Replacement Fund credits are included, comprises 30% or \$6.4 billion of the State's expenses. All but \$718.4 million of this is funded from general revenues. These education expenses are composed of tuition support, transportation, and the average daily attendance flat grant distribution. \$4.1 billion (19%) was spent for general government expenses. These expenses include local distributions and money for State administration and those functions that serve the State as a whole.



General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

A Detailed Analysis of the Four Primary Revenue Sources

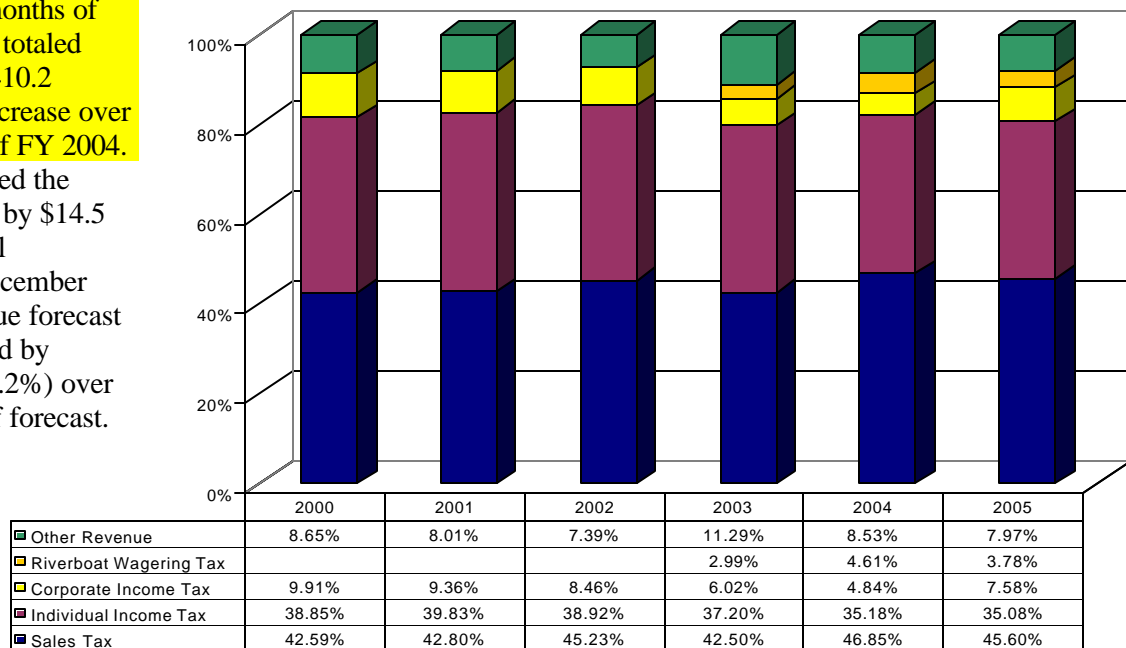
The General Fund and Property Tax Replacement Fund receive revenue from sales tax, individual income tax, corporate income tax, riverboat wagering tax, and other sources. The other revenue sources include items such as cigarette tax, inheritance tax, alcoholic beverage tax, and interest. The percentages that each of the four categories of revenue contribute are depicted in the chart below.

The Economic Forecast Committee prepares the revenue forecasts. On December 14, 2004 the committee issued a new forecast which increased the FY 2005 revenue estimates by \$310.5 million (2.8%). \$216.4 million of the increase was projected for the first six months of FY 2005. The revised forecast projects a \$692.4 million (6.5%) increase over the \$10.6 billion revenue received in FY 2004.

Total Budgeted Revenues

For the first six months of FY 2005 revenue totaled \$5.4 billion - a \$410.2 million (8.3%) increase over the same period of FY 2004. Revenues exceeded the 12/14/04 forecast by \$14.5 million (0.3%), all attributable to December 2004. The revenue forecast has been increased by \$216.4 million (4.2%) over the prior first half forecast.

General and Property Tax Replacement Fund Revenue Percentage by Type
First Six Months of Fiscal Year



Sales Tax

In the first half of FY 2005, sales taxes accounted for 45.6 % of the General Fund and Property Tax Replacement Fund revenue (General Fund revenue). For the first half of FY 2005, sales tax receipts were \$124.9 million (5.4%) higher than FY 2004 and \$525.3 million (27.3%) higher than FY 2003. The tax rate increased from 5% to 6% effective December 1, 2002 which accounts for the large increase from FY 2003 to FY 2004. However receipts were \$9.3 million (0.9%) below the revised revenue forecast issued on 12/14/04.

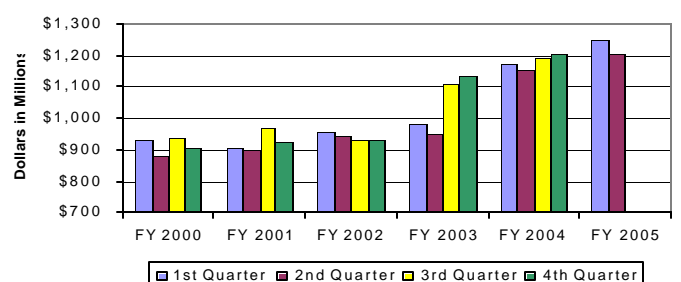
The decrease was all attributable to December 2004 because the revised forecast raised the first half FY 2005 sales tax revenue estimate by \$16.9 million to match actual revenues received.

Sales Tax

(Dollars in Millions)

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1st Quarter	928.1	903.9	953.1	978.9	1,172.8	1,247.5
2nd Quarter	877.1	895.3	942.3	945.6	1,152.0	1,202.2
3rd Quarter	936.9	970.1	933.3	1,111.7	1,193.1	-
4th Quarter	909.3	924.6	932.7	1,136.4	1,203.0	-
Total	3,651.4	3,693.9	3,761.4	4,172.6	4,720.9	2,449.7

Sales Tax Collections



General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

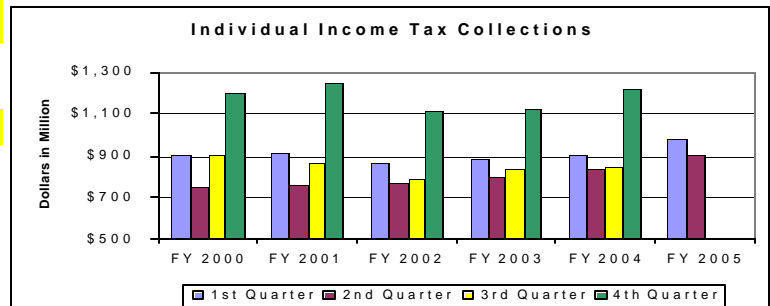
A Detailed Analysis of the Four Primary Revenue Sources (Continued)

Individual Income Tax

Individual income taxes accounted for 35.1% of General Fund revenue in the first half of FY 2005.

First half FY 2005 revenue was \$138.9 million (8.0%) above the amount collected for the same period in FY 2004 and \$200.1 million (11.9%) above the amount collected the first six months of FY 2003. The individual income tax revenue for the first half of FY 2005 was \$2.7 million (0.9%) below the revised revenue forecast. The decrease was attributable to December 2004 because the revised revenue forecast raised the first half FY 2005 estimated individual tax revenue forecast by \$89.5 million to match actual revenues received.

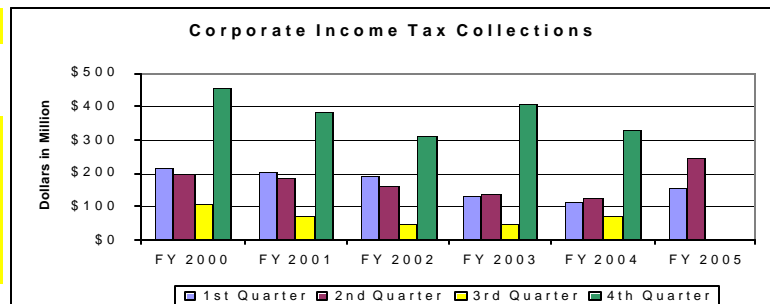
	Individual Income Tax (Dollars in Millions)					
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1st Quarter	901.5	912.6	860.2	884.7	904.0	980.8
2nd Quarter	745.5	762.1	770.8	799.7	841.6	903.7
3rd Quarter	906.5	859.3	793.7	832.8	845.4	-
4th Quarter	1,199.8	1,245.8	1,116.1	1,127.1	1,216.9	-
Total	3,753.3	3,779.8	3,540.8	3,644.3	3,807.9	1,884.5



Corporate Income Tax

Corporate income taxes accounted for 7.58% of General Fund revenues in the first half of FY 2005. First half collections were \$167.0 million (69.6%) above first half collections in FY 2004. The revenue was \$25.8 million (6.8%) above the revised forecast which was increased by \$110.7 million for the first half over the previous forecast. The increase occurred in December 2004. Collections were also \$134.2 million (49.2%) above collections for the same period in FY 2003. Trend analysis of corporate income tax is complex because of tax changes enacted to create a more business-friendly environment, the move away from a purely gross receipts tax, and a phasing out of the inventory tax.

	Corporate Income Tax (Dollars in Millions)					
	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
1st Quarter	220.4	205.6	189.8	132.3	114.2	157.4
2nd Quarter	199.7	187.9	164.5	140.5	125.8	249.6
3rd Quarter	108.6	75.7	44.2	50.2	73.9	-
4th Quarter	456.6	386.1	310.9	406.1	330.9	-
Total	985.3	855.3	709.4	729.1	644.8	407.0



Riverboat Wagering Tax

Riverboat Wagering Tax accounted for 3.78% of the General Fund revenue for the first half of FY 2005. Collections declined by \$25.5 million (11.2%) over the same period in FY 2004 and increased by \$67.5 million (49.8%) over the same period in FY 2003.

The majority of the fluctuation is a result of a change in rate structure that occurred at the same time that continuous dockside boarding was approved. As a result there was a large catch-up collection of wagering tax in July 2003 (FY 2004). The same legislation also enacted riverboat revenue sharing among non-riverboat counties, capped the amount received by local government in riverboat counties, and significantly increased the State's share of riverboat wagering revenues.

	Riverboat Wagering Tax (Dollars in Millions)		
	FY 2003	FY 2004	FY 2005
1st Quarter	Prior to fiscal year 2003 riverboat wagering taxes were not deposited into the General and Property Tax Replacement Fund.	49.4	114.0
2nd Quarter		86.2	114.6
3rd Quarter		118.3	175.9
4th Quarter		176.9	197.0
Total		430.8	601.5

